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SUBJECT: WHAT'S BEHIND THE OIL CUTOFF TO THE CZECH REPUBLIC?

REF: PRAGUE 447

Classified By: John R. Beyrle for Reasons 1.4 (b/d)

SUMMARY

¶1. (C) It is impossible to know whether last week's abrupt drop in oil supplies to the Czech Republic was driven by politics or not. Some analysts see pure politics behind the move. Others say it was likely driven by private, if non-transparent, profit motives. The GOR vehemently denies any political link. The Czech Embassy believes that while politics may have played a role, the cutoff has clearly not served the Kremlin's interests and may have even raised the Kremlin's ire against independent actors in the oil trading business. Transneft has provided both technical and market reasons for the dropoff. One thing all our interlocutors, including at Transneft, agreed on was that the oil trading business in Russia is murky. In all the guessing and finger-pointing, perhaps the best lesson from this episode is that consumers in the Czech Republic have escaped relatively unscathed (reftel) thanks to the country's open oil market. This fact buttresses our efforts to promote free markets as the best guarantors of energy security. End summary.

OFFICIAL EXPLANATION AND CZECH VIEWPOINT

¶2. (C) Czech Charge d'Affaires Hynek Pejcha told us July 18 that his government has yet to receive an official response from the GOR explaining the reasons behind the 50% drop in oil supplies to the Czech Republic from Russia via the Druzhba pipeline. However, Transneft President Nikolai Tokarev personally explained to Hynek that the reduction in oil supplies was caused purely by the commercial decision of two suppliers, Transneft and Bashneft, to divert oil to other markets. As also reported in the press, Tatneft diverted oil to Turkey and Bashneft to domestic refineries. Tokarev stressed that his company only transports oil and is not involved in oil trading. Pejcha explained that, as his government understands it, the Russian suppliers each sell their oil to an off-shore trading company which then sells it to another off-shore trading company, in this case "Laturna" (which apparently surfaced only a few months ago), which then sells it to buyers in the Czech Republic. Pejcha said his government does not know who owns the oil traders and that Tokarev himself admitted that the oil trade is very non-transparent. Tokarev said the Czech Embassy should

receive an official response from the MFA very shortly.

¶13. (C) Pejcha then offered his own analysis of the situation, admitting that it's impossible to know the truth. On the one hand, he believed the GOR must have at least known about the cutoff since "they control the oil and gas business 100%." On the other hand, Pejcha continued, this situation "in no way serves the Kremlin's interests." He explained that the cutoff, coming on the heels of the missile defense agreement, provides fodder for missile defense supporters in the Czech Republic to point to Moscow as a nefarious influence. Pejcha theorized that unknown individuals, either in Bashneft and Tatneft or somewhere else along the murky oil trading chain, stood to gain personally from the oil diversion, and could have acted without any political directive or blessing. He suggested that the move may in fact have raised the Kremlin's ire. He added that if the Kremlin wanted to strike an economic blow against the Czech Republic, a gas shutoff would have been much more painful, given the lack of alternatives for gas consumers versus the multiple sources of oil.

¶14. (C) Pejcha repeatedly expressed personal and official appreciation for USG expressions of concern and support. He said his embassy had only asked for a meeting with Transneft vice-president but got Tokarev himself because, as Tokarev explained, Transneft had received inquiries from the U.S. and the E.U. Tokarev specifically mentioned to Pejcha a letter from the Ambassador requesting a meeting for Special Envoy Gray and Eurasian Energy Coordinator Mann. (Note: We had sent the letter without any specific agenda, but, given the timing, Tokarev had apparently interpreted it as related to

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the situation with the Czech Republic. End note.)

"TECHNICAL" REASONS?

¶15. (C) At least at first, Transneft gave us a completely different explanation than that given to Pejcha. Oleg Pilipets, international affairs advisor to Tokarev, told us July 14, just after the incident hit the press, that the reduction in oil supplies had "absolutely nothing to do with politics." He vehemently denied any directive from the GOR to shut off supplies to the Czech Republic, blaming the cut on "technical" reasons caused by Ukraine's actions along the portion of the pipeline crossing its territory. The "technical" excuse was widely cited in the press, but without any explanation.

¶16. (C) Pilipets explained that Ukraine periodically experimented with oil flows along the Odessa-Brody pipeline (which connects to the Druzhba) and that in this case, this activity would have caused oil from other sources to mix with and disrupt flows through Druzhba. When Transneft heard about the possibility of this action, it notified its suppliers, saying it could not guarantee the consistent quality and quantities of flows through Ukraine. Pilipets said some of the oil producers then diverted some of their oil supplies in response, causing the drop in deliveries to the Czech Republic. On July 18, after press reports quoted Tatneft and Bashneft representatives citing "market reasons," Pilipets told us the cutoff was a result of the combination of technical and market causes. He added that "the oil trading business is not very transparent."

ECONOMICS?

¶17. (C) Russian political and energy analyst Vladimir Milov, a former Deputy Minister of Energy, called the GOR's initial claims of technical causes "stupid." He added, however, that politics is also an unlikely cause in this case. Milov believed the most likely explanation is economic, with

traders simply having found an opportunity to increase profits. He said excess pipeline capacity due to production stagnation in Russia allows for easy shifts in oil deliveries. Yet Milov, too, concluded that it is difficult to get to the root of this episode because the oil trading business is "mysterious."

¶8. (C) Anton Mifsud-Bonici, a BP executive in Moscow, supported the economic theory, explaining that oil trading is very fluid and that the traders constantly move oil in response to market conditions.

POLITICS?

¶9. (C) The GOR, of course, adamantly denies any connection between the oil cutoff and the signing of the missile defense agreement. Deputy Foreign Minister Kislyak told the Ambassador July 17 that missile defense had nothing to do with it." Some long-time observers of the Russian energy sector disagree. Vladimir Konovalov, the president of the Petroleum Advisory Forum (PAF, the association of "Western" oil companies in Russia), called the move "surely political." Ironically, Mifsud-Bonici had cited Konovalov as a source for the "economic" explanation.

¶10. (C) Jerry Rohan, former head of the energy consulting unit PriceWaterhouseCoopers in Russia and a 15-year resident with close ties to the sector, echoed Konovalov's viewpoint. "Absolutely political," Rohan told us. "They always cite technical or other reasons, but it's always political." Rohan, too, however, added that no one will ever know the truth because "this whole business is totally non-transparent."

COMMENT

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¶11. (C) While the causes of the oil cutoff to the Czech Republic will likely remain unclear, what is clear is that Czech consumers didn't feel much, if any, pain as a result. A Shell representative here confirmed that the company's refinery has multiple sources of oil and does not view this as a problem, a view supported by Pejcha. It seems to us the lesson here is that a free energy market on the consuming end alleviates problems, intentional or not, caused by any single supplier. End comment.

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